Testimony of Franklin J. Vargo
Vice President, International Economic Affairs
National Association of Manufacturers

On Behalf of
The National Association of Manufacturers
Before the
Subcommittee on Commerce, State, and the Judiciary
Of the House Committee on Appropriations

On
How Trade with China Affects American Manufacturing

May 22, 2003

Mr. Chairman and Members of the Subcommittee:

I am pleased to testify today on behalf of the National Association of Manufacturers (the NAM), and I want to compliment you, Mr. Chairman, for holding this hearing on what is one of the most important challenges facing U.S. manufacturing.

The NAM represents 14,000 U.S. manufacturing companies, including 10,000 small and medium-sized firms, and I can tell you that no other trade subject comes close to commanding the sort of attention that China is getting from both large and small NAM members. China poses a unique set of challenges for U.S. manufacturers. The issues go both ways. While competition from Chinese imports and fear that U.S. manufacturers will move production to China dominate the concerns of many companies, others see China as their only growth market.

Underscoring the importance of China to the NAM, the President of the NAM, in fact, is meeting with a number of members of the NAM Board of Directors this afternoon to discuss views on addressing the challenges posed by China. Mr. Walter, the Chairman of FMC corporation, who is also testifying before this sub-committee today, will be among those participating in this meeting. As the NAM is in the process of determining views and possible recommendations, my purpose today is not to prejudge what the NAM will recommend, but is to put manufactures trade with China in perspective and to offer some observations that may be useful in pointing to areas where the U.S. government should act.

Competition with China cannot be viewed separately from the broader competitive problems facing U.S. manufacturers – importantly including the factors that are making it more expensive to produce in America at the same time that cost increases cannot be passed on in the form of price increases. Illustrating the problem, since 1994 prices in the rest of the economy have risen 18 percent, but prices of manufactured goods as a whole have fallen steadily and now stand nearly 6 percent below their 1994 level. Cost pressures, though, have continued, including those from tax and regulatory policy, a long-overvalued currency, excessive litigation, increasing health care costs and energy prices. Something had to give, and that has included a lot of manufacturing jobs.

Representing American manufacturers, I can tell you that manufacturing feels under siege. More than 2 million American factory jobs have been lost in a little over two years – more than one in every ten jobs. Forty-nine states shared in these losses, with only Nevada showing a slight increase. Manufacturing lost more than 95,000 jobs last month alone. The current economic slowdown is essentially a manufacturing recession – a deep one. The rest of the economy, while not growing at its usual rate, has not felt the same pain as manufacturing. Manufacturing represents 14 percent of the American workforce, but has accounted for nearly 90 percent of all the job losses since total U.S. employment peaked in March 2001.

While manufacturing employment has fallen more than 10 percent since that time, employment in the rest of the economy has fallen only two-tenths of one percent. In other words, your odds of losing your job have been nearly 50 times as high in manufacturing as in the rest of the economy. No wonder 75 percent of manufacturers in a recent NAM survey said that manufacturing is in crisis.

Trade is not the only reason for this -- but it is an important reason. Trade – both imports and exports – affects manufacturing much more than the rest of the economy. In fact, trade is seven times as large a factor in the manufacturing sector than in the rest of the economy. Trade has been a key factor in the current manufacturing recession – particularly the decline in U.S. manufactured goods exports. These exports fell $34 billion last year, accounting for 80 percent of the total fall in U.S. manufacturing production in 2002. This is a serious matter for the whole economy – for manufactured goods account for two-thirds of all U.S. exports of goods and services. Manufactured goods are how we pay our way in the world, and in the absence of a vibrant manufacturing sector, we will not be able to continue our living standard.

Imports have also been a factor in the current situation. Since 1997 import penetration (the import share of the U.S. market for manufactured goods) increased 4 percentage points, raising imports nearly $180 billion above where they would have been had the import share stayed at the 1997 level. That import increase accounted for over 50 percent of the growth in U.S. apparent consumption of manufactured goods since 1997. In the case of durable goods, imports took about two thirds of the growth in U.S. apparent consumption. This competition has put enormous pressure on U.S. producers.

It is important to stress that imports are not "bad" for the economy. They must, of course, be consistent with international trade rules and U.S. trade laws. Imports are how we receive goods and services that can be produced more efficiently in other countries, and exports -- which tend to be the goods and services we make most efficiently -- are how we pay for what we import. Imports provide a broad range of products to industry and consumers and enhance the U.S. living standard. So long as trade is in reasonable balance, some U.S. industries are growing while others are contracting -- but manufacturing as a whole gains and becomes more productive. This doesn't alleviate the difficulties of individual companies or industries, but tends to bring about the movement of resources within the economy in a way that generally benefits all. But when trade is not in reasonable balance, then manufacturing as a whole can be hit hard and firms losing customers cannot find other outlets for their production and workers displaced from one industry cannot find employment in another.

The overall U.S. merchandise trade deficit rose from $180 billion in 1997 to $470 billion last year -- roughly a $300 billion increase. About 80 percent of that increase occurred in manufactured goods trade, which went from a deficit of $130 billion in 1997 to a deficit of $360 billion last year. The $230 billion increase in the manufactured goods deficit has had a very serious effect on U.S. production and jobs. A robust manufacturing recovery and restoration of many of the lost jobs just is not possible until manufactures trade turns around.

Imports from China have played an important role here, but have not been the most significant factor. For example, the largest increase in the U.S. trade deficit since 1997 was not with China, but with the European Union – where the deficit increased from $16 billion in 1997 to $82 billion last year. The U.S. deficit rose virtually everywhere in the world. The increase in the trade deficit with China accounted for about one-fifth of the total increase in the U.S. manufactured goods deficit – significant, but not decisive.

The fundamental cause of the overall deterioration in the trade balance was the seriously overvalued dollar. No other factor even comes close. After a decade of stability, the dollar started rising against other currencies in 1997, and peaked at an increase of 30 percent in February 2002 – making U.S. exports 30 percent more expensive and imports up to 30 percent cheaper. For example, the euro fell from $1.17 to $0.86, making it impossible for many American companies to compete in Europe or against European companies. This particularly affected smaller U.S. manufacturers and had a disastrous effect on our trade. This is why the NAM worked so hard to obtain a dollar policy based on market-determined exchange rates reflecting economic fundamentals.

The Administration began enunciating such a policy last year, and since then the dollar has moved about two-thirds back to normal levels, when viewed against major currencies. Recently, Treasury Secretary Snow has been very definite in his statements that markets must set currency values free of intervention to prop currencies up or keep them below market-determined rates. A dollar reflecting economic fundamentals is by far the most important factor needed to cut back the enormous U.S. trade deficit.

The euro is now about $1.17, which is close to the $1.20 average value during the 1990s for the European currencies that now constitute the euro. The Canadian dollar also rose significantly, from $0.63 to $0.73 – an increase that will do much to alleviate some of the significant trade tensions that have arisen with Canadian trade.

We are encouraged by statements in Europe and Canada indicating a recognition that these currency rates are reasonably reflective of the economic fundamentals. Major Asian countries, however, including China and Japan, still act to prevent market forces from adjusting their currencies in an effort to keep their export prices down and boost their exports. This is a huge problem, one to which I shall return later in my statement.

IMPORTS FROM CHINA

Let me now turn specifically to trade with China trade and its effects on U.S. manufacturing. Beginning in the 1970s, the United States granted what is now called "Normal Trade Relations" (NTR) status to China, opening the way for China to begin selling into the U.S. market. China faced the same small U.S. import duties that we applied worldwide, averaging less than 2 percent for manufactures.

The Chinese market, however, stayed very closed to U.S. exporters. Over the years, this situation led to faster growth of China's exports to the United States than was the case for U.S. exports to China. In fact, for the last 20 years, U.S. imports from China have grown at an average annual rate of 20 percent per year, while U.S. exports to China have grown at an average annual rate of 12 percent. As shown in Exhibits 1-4 attached to my statement, this led to a rapidly growing deficit.

Last year U.S. merchandise imports from China were $125 billion, while exports to China were $22 billion, resulting in a trade deficit of $103 billion – the largest with any country in the world. U.S. imports from China are now six times as large as exports to China, and Exhibit 5 shows just how difficult a task it is merely to halt the growth of the deficit much less than to reverse it. The exhibit contains a matrix showing the trade balances with China that would result from various alternative growth rates for exports and imports. If, for example, the 20-year trends of 20 percent import growth and 12 percent export growth were to continue for just five more years, the U.S. trade deficit with China would triple to over $330 billion.

The problem is still manageable, if it is addressed now. In 2002 total U.S. manufacturers' shipments, the sum total of all sales of U.S.-made manufactured goods, were $3.9 trillion. Manufactured goods imports from China were $122 billion – just 2.9 percent of the total U.S. market for manufactured goods. While there is no question that some U.S. industries are reeling under Chinese competition and others are coming under increasing pressure, the problem has not yet become so widespread that it cannot be solved.

Not all of China's rapid export growth to the U.S. market is necessarily competing with U.S. production. Exhibit 6, for example, shows how Japan's share of the U.S. market has been falling as China's has risen -- implying the possibility of considerable substitution of Chinese for Japanese goods in the U.S. market.

For example, China is now the largest supplier of computers and related components into the U.S. market. Yet as recently as 2000, China was only our fifth-largest supplier of these products. Though total U.S. imports of computers and components fell from 2000 to 2002, imports from China soared nearly 50 percent, while imports of these products from Japan fell 50 percent and from Korea fell over 40 percent.

More disquieting to American manufacturers is that Chinese imports are beginning to compete against U.S. producers in a growing range of U.S. industries where they have not been a major factor before. This can happen with remarkable speed.
For example, U.S. machinery imports from China have risen nearly 50 percent over the past year. Many of these products are being offered for sale at prices so low that the U.S. company just cannot compete. In fact, it is not unusual to hear that the Chinese product is being offered for sale at prices below the cost of the U.S. company's component or raw material costs. One NAM member told us, "I recently lost a job to China when they built three molds for my domestic customer for a total of $1,800. The cost of the steel is more than that!" That raises serious questions that need answering, for even low labor costs and an undervalued currency could not bring about such a phenomenon.

CHINA AS A MARKET

In addition to being a rapidly rising supplier of imports into the U.S. market, China is also a quickly growing market for foreign goods and services, and this must not be overlooked. Last year China was our fastest-growing export market. While our overall exports fell 5 percent, our exports to China were up 15 percent. Last year China was the second-largest market for U.S. commercial jet aircraft. China has the same potential for many products.

Moreover, the growth is accelerating. In the first quarter of this year our exports are up over 37 percent compared to the year-ago period -- by far the fastest growth to any market in that time period. Moreover, there is enormous potential for expansion. Less than 10 percent of China's imports come from the United States. The European Union, for example, sells 30 percent more to China than we do. .

It is also important to contemplate the significance of the fact that China's trade with the rest of the world as a whole is in deficit. In 2002, using U.S. data, China's surplus with us was $103 billion. China's global trade surplus was $30 billion, implying a $73 billion deficit with the rest of the world. While much of this is probably imports of oil and other commodities, it is instructive to note that China had a $10 billion trade surplus with the European Union and had a trade deficit with Japan.

INVESTMENT IN CHINA

Another growing concern among many companies is the fear that U.S. factories are closing their doors and that production is moving to China. There is a considerable amount of anecdotal information regarding U.S. plants shutting down and new American plants being opened in China. The statistical data, however, do not bear this out--at least not so far.

As shown in Exhibits 7 and 8, total sales of U.S. manufacturing affiliates in China in 2000 (latest data available) were $26.0 billion, of which $18.3 billion were sold in China, $4.8 billion were exported to countries other than the United States, and $2.9 billion were exported to the United States. Thus, according to U.S. data, only 3 percent of U.S. manufactured goods imports from China in 2000 came from U.S.-owned companies. The rest came from Chinese or foreign-owned plants. Additionally, over 90 percent of U.S. affiliate exports of manufactures to the United States were computers and other electronic components.

Preliminary data for 2001 do not indicate a significant change. Global U.S. foreign direct investment outflows for manufacturing in that year were $36 billion, of which 80 percent went to Europe and Canada. This is in keeping with typical patterns, for the vast bulk of U.S. foreign direct investment in manufacturing typically goes to Europe, Canada, and other high-wage countries to supply local demand. New U.S. manufacturing investment in China in 2001 was $1.4 billion, according to the Commerce Department's data.

Thus the statistics and the anecdotal information seem to be saying different things. In seeking to reconcile this, it should be noted that the statistics would not reflect instances in which a U.S. firm ceased production and rather than investing in China, simply started to import products made by Chinese-owned or other foreign-owned factories. Additionally, we may just be at the beginning of the problem. It is a rare executive who returns from China without shaking his or her head and saying that unless things change they just don't see how we can compete against Chinese production and keep American manufacturing from moving offshore.

A POSITIVE AGENDA

The question is, what do we do about this? How do we assure the health of our nation's manufacturing industry in the face of this rapidly growing challenge? At the outset, we must reject protectionism as the answer. We cannot undo seventy years of trade liberalization and the attendant benefits to our standard of living and our competitiveness that have resulted from trade. Protecting industries from competition is not a formula for success and would likely result in a spread of protectionism around the world that would end up hurting everyone -- including ourselves.

We need a positive agenda in addressing China. We need to recognize that China is not only our fastest-growing competitive problem right now, but also that it is going to be among our fastest-growing markets in the world. We need a combination of steps to ensure that trade follows market principles and is free of government distortions, and to ensure that American productivity and technology continues to provide us a competitive edge. I am not posing a set of solutions today, but would like to point to some areas in which action may be fruitful.

WTO -- The first step has already been taken: getting China into the WTO so it has to follow global trade rules. We worked hard to get China into the WTO for this very reason. We need to dispel the too-common view that China's entry into the WTO is the cause of the rapid rise of imports from China.

Exhibit 1 shows that this trend started a long time ago, and was not a creation of China's WTO entry. The U.S. market was already open to China before its entry into the WTO. The United States made no import concessions when China entered the WTO -- no reductions in U.S. tariffs or other trade rules whatsoever. All of the concessions, and all of the reductions in barriers are on the Chinese side. That was the price they had to pay to join the WTO.

Our exports, on the other hand, have clearly broken from their earlier trend and have started rising considerably more rapidly than before China's entry into the WTO. This is exactly what we expected -- the direct result of the reduction in tariff and trade barriers that has already taken place in China. As China implements its several-year schedule of further market opening moves, much more U.S. export growth is achievable.

Enforce Trade Obligations -- We must now look to the fullest implementation of China's WTO commitments. We cannot assume that everything will take care of itself and that China will implement everything faithfully without prodding. We should not hesitate to use our rights. U.S. government trade agencies have beefed up their China compliance activities, and we want these resources to be used aggressively. China's initial track record shows many positive achievements, but there are some problems that have already become evident.

Let me give you an example, where the NAM is cooperating with the Semiconductor Industry Association. China applies a 17 percent value-added tax (VAT) on all semiconductor sales. In an attempt to encourage local production, China has been granting rebates of VAT collected on sales of products made domestically. Semiconductors made in China are eligible for a rebate of the VAT burden in excess of six percent, and chips designed and made in China receive a rebate of the VAT burden in excess of three percent.

China's WTO commitments include providing national treatment to foreign products. Specifically, China committed to "ensure that internal taxes and charges, *including value-added taxes* ... shall be in conformity" with WTO rules. These rules state that imported products "shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products." It seems pretty clear to us that a lower VAT granted only on sales of products made domestically violates China's WTO obligations.

Today, China's $15 billion semiconductor market is the third largest country market in the world and is growing rapidly. The U.S. industry has experienced a severe downturn, and China is the fastest growing market available to it. We need to be able to compete there. This is a serious matter not just to the semiconductor industry -- important as it is -- but to all U.S. manufacturing. The products of the U.S. semiconductor industry are indispensable to the development of virtually all new technologies and are the underpinning of the technology edge that we must have if we are to continue to raise the U.S. standard of living.

Market-Determined Currency -- Third, we must press China to end the manipulation of its currency and allow the yuan/dollar exchange rate to be determined by the market. Since 1994, the Chinese government has artificially suppressed the value of the yuan against the dollar in order to gain a competitive advantage.

In doing so, the Chinese government has accumulated $300 billion in foreign exchange reserves – $100 billion last year alone. This one-year increase just about equaled the U.S. trade deficit with China. One way of looking at it is that China is buying and holding dollars rather than buying more goods and services. By some estimates, the yuan is 40 percent undervalued. If this estimate is correct, then the Chinese currency is a major factor in our rising trade imbalance. Certainly some in the Chinese business press see that as the case -- saying the currency makes Chinese products "dirt-cheap."

Both in the short and long-term, there may be no other event that could make as large and as fast a difference in U.S. - China trade than having the Chinese currency become market-driven. Both the International Monetary Fund and WTO rules proscribe currency manipulation for the purpose of obtaining a competitive advantage or to interfere with the working of trade liberalization. This is something the NAM and the 80+ member Coalition for a Sound Dollar have been urging the Administration to look at closely.

Clamp Down on Counterfeiting -- There should also be a focus on ending product counterfeiting. According to the International Chamber of Commerce, fake products comprise upwards of 5 percent of world trade, and the share is getting worse. All informed parties agree that China is the world's primary source of fake products. Counterfeiting lowers the export of genuine U.S. products to China, robs firms of jobs and revenue, and creates health and safety risks.

Enforcement in China is administrative, rather than criminal. Some fake products are seized, but – until one recent case -- no machines are impounded and no people are arrested. Thus, there has been no deterrent effect. China's efforts are woefully inadequate and we must press them to prosecute criminally.

Trademark procedures have fallen far short. New rules have just been written, and we will review them carefully when a translation is available. We hope they will bring a big improvement over present practice. To date, however, there has been a glaring lack of national treatment, especially with the list of so-called "well-known marks" that is supposed to serve as an enforcement tool. No foreign companies -- only Chinese companies -- are on that list. Additionally, China is making no known serious effort to stop fake goods from leaving the country, despite what appear to be their obligation to do so under the 1992 bilateral agreement on intellectual property.

Additionally, I want to note that the importation of counterfeit products into the United States represents a growing problem for the American manufacturing and consumers alike. American manufacturers have becoming increasingly active in their efforts to protect their intellectual property, not only in the courts, but with U.S. customs officials. If anti-counterfeit enforcement is effective at the port of entry, U.S. manufacturers and the judiciary can avoid the expense of subsequent legal costs because the counterfeit product has made it into the U.S. market. For the Customs Service to succeed, they need support from the U.S. manufacturers who are willing to provide training to help inspectors recognize and detect counterfeit products and to assist in their seizure efforts.

Yet the time and financial resources available to customs inspectors for this training and anti-counterfeiting enforcement are now being squeezed, and we fear that enforcement will suffer. Congress must ensure that the intellectual property enforcement activities of the Customs Service are adequately staffed and funded.

Trade Must Follow Market Principles -- We must ensure trade follows market principles and does not receive direct or indirect subsidies that distort trade flows. Prices must reflect real economic costs. Low labor costs and an undervalued exchange rate are not enough to explain the frequent complaint from our members that Chinese products are offered for sale at less than the cost of the components or raw materials. The NAM is beginning an effort with its members to document these cases. When we have sufficient information, we will bring this to the attention of the Commerce Department and USTR. If there are widespread subsidies or below cost sales, these should be dealt with.

Export Promotion -- Finally, we believe that the United States must initiate a massive export promotion program to increase the growth rate of U.S. exports to China. Exhibit 2 shows that rapid export growth has already begun to occur as China opens up its market. But Exhibit 3 shows how far we have to go. Exhibit 5, which projects alternative growth rates and deficits, shows we simply must get that export growth rate up. We need to see it average at least 25 percent a year -- and we would like to see it at more than 30 percent a year. We believe this is possible as China opens up its markets under WTO requirements -- but only if U.S. companies greatly step up their export marketing. Commerce Department export promotion programs are absolutely essential in this regard. Commerce's programs have proven they work -- but a huge increase will be needed for China.

We are talking to NAM member companies in an effort to determine just what sorts of promotion assistance they believe would be most useful, but a very important element could be the establishment of a network of American Trade Centers to provide direct support to American business.

CONCLUSION

Let me conclude, Mr. Chairman, by stating that ultimately we will not succeed in preventing the migration of our manufacturing base to China and other foreign countries if we do not address the high cost of manufacturing in the United States and get the U.S. economy moving again. The tax reforms now being debated in Congress would go a long way to reducing the tax burden on U.S. industry and providing economic stimulus. But more is needed.

U.S. industry is burdened by legal and regulatory systems that retard growth and destroy jobs. Unrestrained asbestos liability alone, for example, could cost U.S. industry $250 billion, resulting in the bankruptcy of even large corporations. Rapidly rising health care costs are a constant worry, particularly for small manufacturers. Uncertainty over sources of energy supply has led to price volatility. Lack of support for research and development threatens to undermine U.S. leadership in cutting-edge technology. And shortages of skilled workers have left many manufacturers wondering how they will keep the engines of industry running when growth does resume.

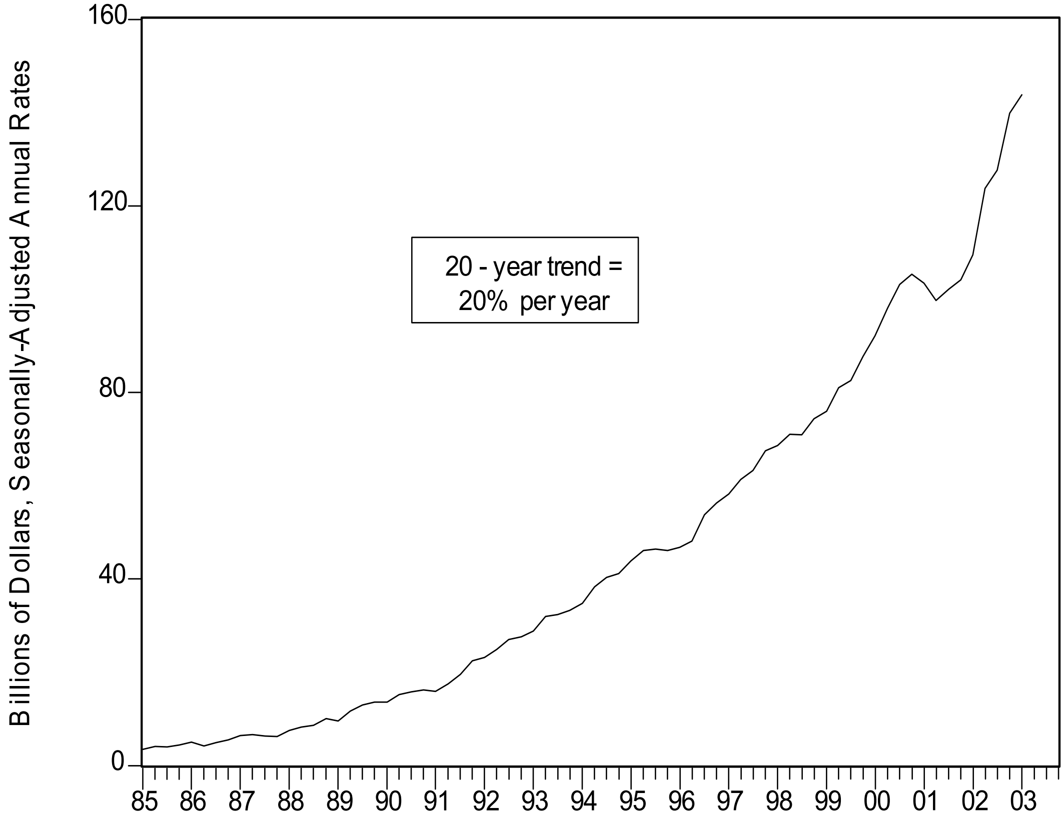
Additionally, bilateral, regional and WTO trade agreements must be negotiated as quickly as possible to get foreign trade barriers eliminated, or at least down to our own low level. U.S. tariffs on manufactured goods average less than 2 percent, while in many parts of the world U.S-made goods face tariffs 10-15 times higher -- or even more.

Unless these challenges are also addressed, we can expect a significant further erosion in the U.S. industrial base. Competition with China will only accelerate the trend. However, if we begin to act now, with both a refocused and positive trade policy toward China and a concerted strategy on economic growth and manufacturing renewal, we can restore the dynamism and competitiveness of U.S. industry and ensure the global leadership that is so central to our economic and national security.

Thank you, Mr. Chairman.

Exhibit 1

U.S. IMPORTS FROM CHINA CONTINUE TO SOAR



Data: Census Bureau, U.S. Dept. of Commerce

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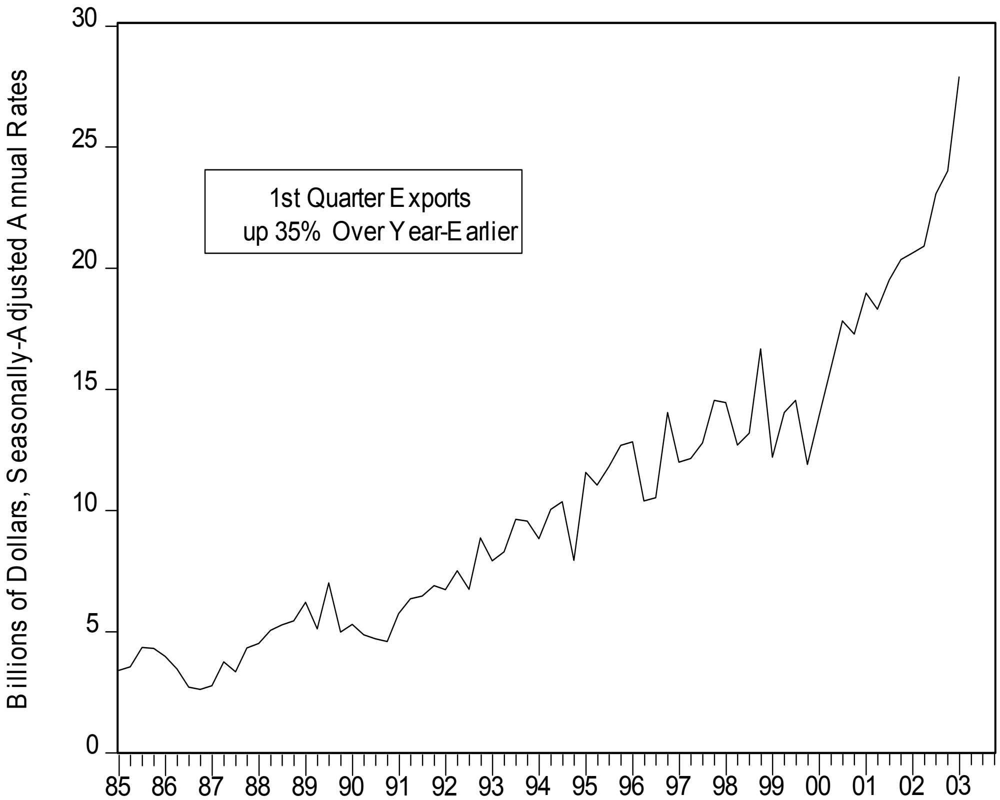
Exhibit 2

U.S. EXPORT GROWTH TO CHINA ACCELERATES AFTER WTO ENTRY



Data: Census Bureau, U.S. Dept. of Commerce

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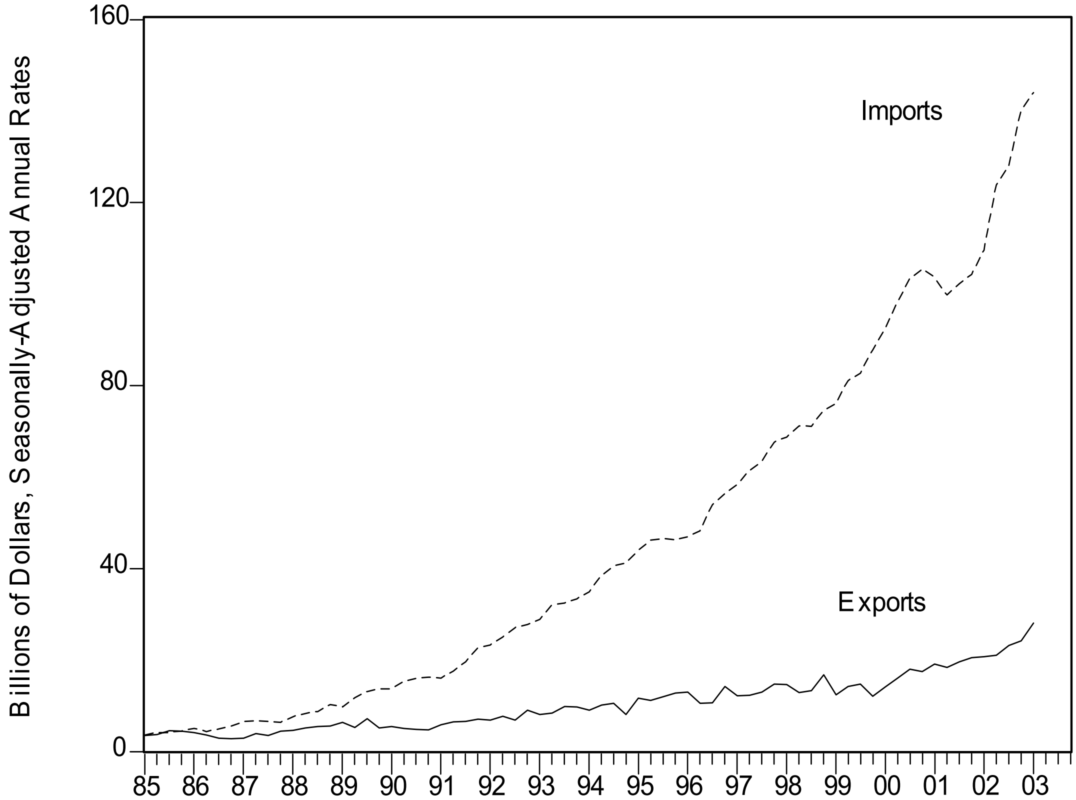
Exhibit 3

CHINA TRADE: SPREAD BETWEEN EXPORTS AND IMPORTS CONTINUES TO GROW



Source: Census Bureau, U.S. Dept. of Commerce

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Exhibit 4

Source: Census Bureau, U.S. Dept. of Commerce

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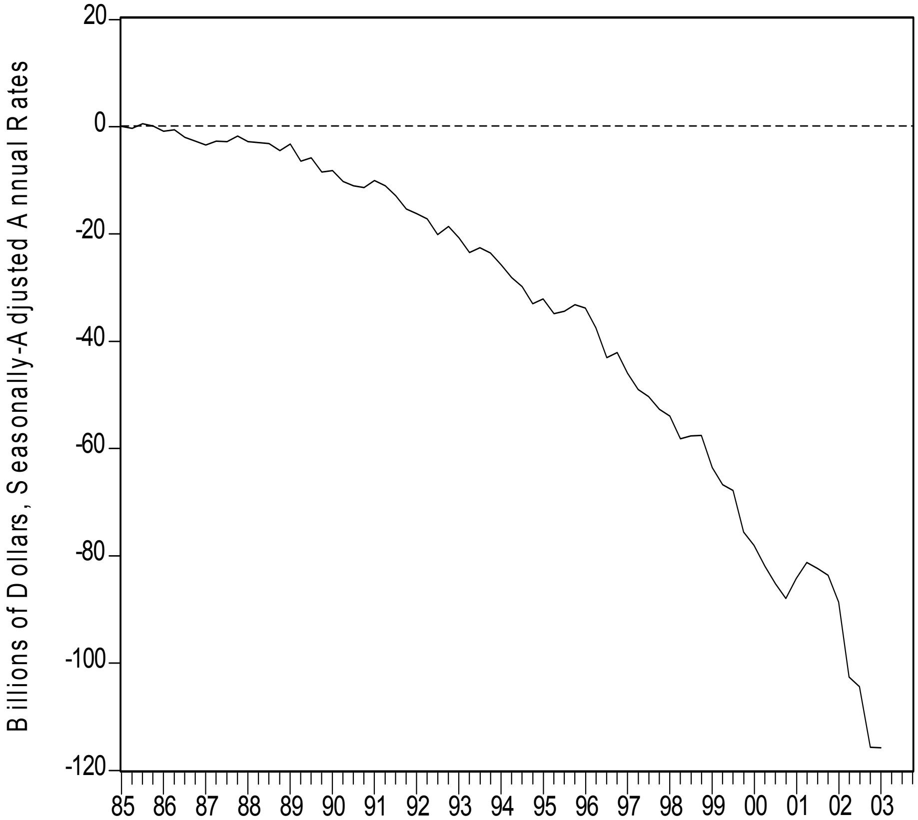
Exhibit 4

U.S. TRADE DEFICIT WITH CHINA NOW RUNNING AT NEARLY $120 BILLION



Source: Census Bureau, U.S. Dept. of Commerce

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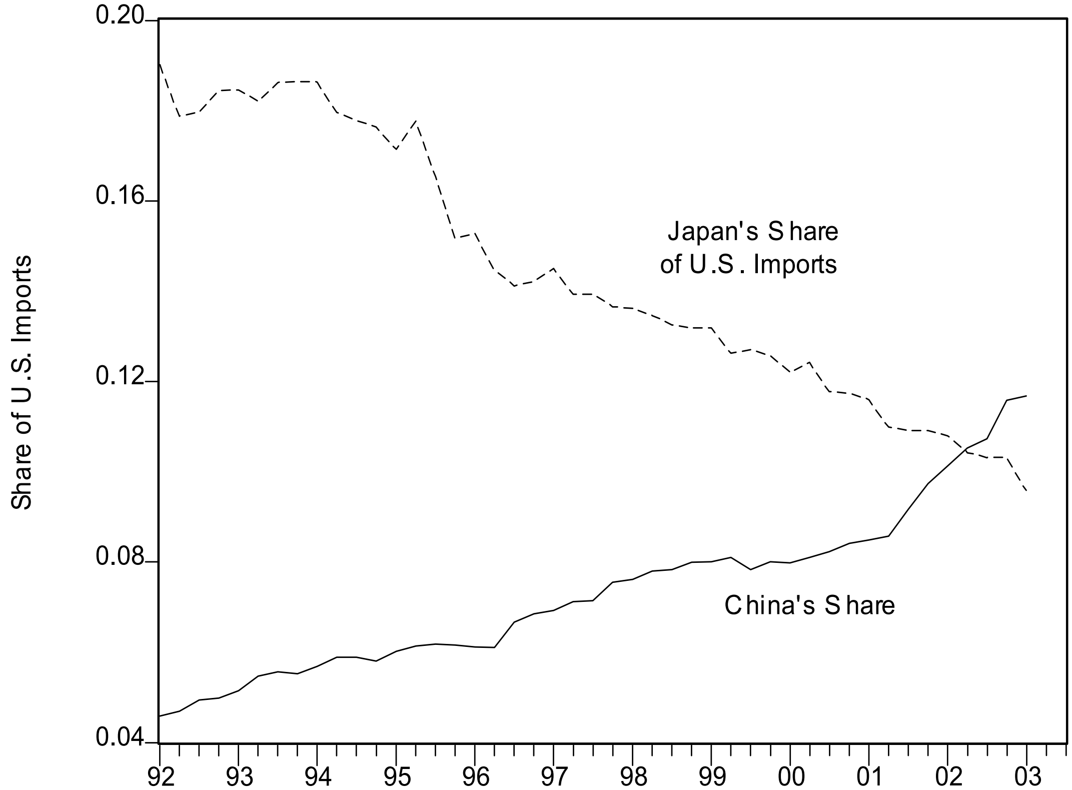
Exhibit 6

IS CHINA MUSCLING JAPAN OUT OF THE U.S. MARKET?



Source: Census Bureau, U.S. Department of Commerce

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Alternative U.S. Trade Deficits With China

20-Year Trend: Exports to China up 12 percent per year; Imports up 20 percent per year

If these trends continue for five more years the China trade deficit will be $330 billion—an increase of $227 billion.

Import% \ Export%	**12%**	25%	33%
20%	**-$330**	-$290	-$252
15%	-$246	-$205	-$167
10%	-$178	-$138	-$100
7%	-$144	-$104	-$66

NAM National Association of Manufacturers

May 2003